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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

COMCON PRODUCTION
SERVICES I, INC.,

Plaintiff and Appellant,

v.

CALIFORNIA FRANCHISE TAX
BOARD,

Defendant and Appellant.

B259619

(Los Angeles County
Super. Ct. No. BC489779)

APPEAL from a judgment of the Superior Court of
Los Angeles County, Abraham Khan, Judge. Affirmed.

Sutherland Asbill & Brennan, Jeffrey A. Friedman,
Daniel H. Schlueter, and Carley A. Roberts for Plaintiff and
Appellant.

Kamala D. Harris, Attorney General, Paul D. Gifford and
Diane S. Shaw, Assistant Attorneys General, Stephen Lew and
Charles Tsai, Deputy Attorneys General, for Defendant and
Appellant.

ComCon Production Services I, Inc., one of approximately 200 subsidiaries of Comcast Corporation, filed an action for the refund of additional corporate franchise taxes assessed by the California Franchise Tax Board (Board) against Comcast Corporation and its subsidiaries (collectively Comcast) for their 1998 and 1999 tax years. The complaint alleged Comcast was entitled to a refund on two separate grounds: (1) the income and apportionment factors of its then majority-owned subsidiary QVC, Inc. should not have been included in the combined report used to calculate Comcast's California tax liability because Comcast was not engaged in a unitary business with QVC during the years at issue; and (2) the \$1.5 billion termination fee Comcast received as a result of the failed merger of Comcast and MediaOne Group, Inc. in 1999 was nonbusiness income that was not subject to any California tax.

Following a 19-day bench trial, the trial court ruled for Comcast on the QVC unity claim and for the Board on the termination fee issue. The Board appealed the portion of the judgment concerning QVC; Comcast cross-appealed the adverse determination on the MediaOne termination fee. We affirm the judgment in its entirety.

OVERVIEW OF GOVERNING LEGAL PRINCIPLES

1. The Unitary Business Principle

California imposes a franchise tax on multistate corporations doing business within the state on the corporation's net income derived from or attributable to sources within California employing the unitary business/formula apportionment method as provided in the Uniform Division of Income for Tax Purposes Act (UDITPA). (Rev. & Tax. Code,

§ 25101;¹ see *Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 755-756 [the federal Constitution “permits taxation of ‘an apportionable share of the multistate business carried on in part in the taxing State’ [citation] and grants states some leeway in separating out their respective shares of this multistate income, not mandating they use any particular formula”]; see also *MeadWestvaco Corp. v. Illinois Dept. of Revenue* (2008) 553 U.S. 16, 19 [128 S.Ct. 1498, 170 L.Ed.2d 404].)

“Under the ‘unitary business/formula apportionment method,’ a state ‘calculates the local tax base by first defining the scope of the “unitary business” of which the taxed enterprise’s activities in the taxing jurisdiction form one part, and then apportioning the total income of that “unitary business” between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation’s activities within and without the jurisdiction.’” (*Hoechst Celanese Corp. v. Franchise Tax Bd.* (2001) 25 Cal.4th 508, 517 (*Hoechst Celanese*).)

“A unitary business is generally defined as two or more business entities that are commonly owned and integrated in a way that transfers value among the affiliated entities.” (*Microsoft Corp. v. Franchise Tax Bd.*, *supra*, 39 Cal.4th at p. 756, fn. 3.) The California Supreme Court has articulated two general and overlapping tests for determining when the incomes from multiple corporations must be treated as parts of a single unitary business under section 25101 and its predecessors. In brief, a unitary enterprise exists (1) if there is unity of ownership, unity

¹ Statutory references are to the Revenue and Taxation Code unless otherwise stated.

of operation and unity of use—generally referred to as the “three unities” test (*Butler Brothers v. McColgan* (1941) 17 Cal.2d 664, 678, affd. (1942) 315 U.S. 501 [62 S.Ct. 701, 86 L.Ed. 991] (*Butler Brothers*)); or (2) “[i]f the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state”—referred to as the “dependency or contribution” test. (*Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 481; see generally Cal. Code Regs., tit. 18, § 25120, subd. (b) “[i]n general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole”].) As discussed below, these tests are not intended to represent a binary choice, but rather articulate related approaches to resolving the question of unity.

2. *Business and Nonbusiness Income*

As provided in UDITPA, California divides all corporate income into two categories—business income and nonbusiness income. (§ 25120; see *Hoechst Celanese, supra*, 25 Cal.4th at p. 518.) “Business income’ means income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.” (§ 25120, subd. (a).) “Nonbusiness income’ means all income other than business income.” (§ 25120, subd. (d).) “All business income is ‘apportioned to this state’ through a formula based on the property, sales and payroll of the taxpayer. [Citation.] In contrast, nonbusiness income is generally ‘allocated in full to the

state in which the taxpayer is domiciled. [Citation.] The tax treatment of corporate income therefore depends on its classification as business or nonbusiness income.” (*Hoechst Celanese*, at pp. 518-519; see *Microsoft Corp. v. Franchise Tax Bd.*, *supra*, 39 Cal.4th at p. 756.)

To determine if a corporation’s income is properly classified as business income, California courts apply both a “transactional” and a “functional” test. Under the former, “corporate income is business income if it arises ‘from transactions and activity in the regular course of the taxpayer’s trade or business.’ (§ 25120, subd. (a).)” (*Hoechst Celanese*, *supra*, 25 Cal.4th at p. 526.) Under the latter, “corporate income is business income ‘if the acquisition, management, and disposition of the [income-producing] property constitute integral parts of the taxpayer’s regular trade or business operations.’ (§ 25120, subd. (a).)” (*Hoechst Celanese*, at p. 527.) Income is apportionable as business income if it satisfies either the transactional test or the functional test. (*Id.* at p. 526.)

PROCEDURAL BACKGROUND

1. *Audit and Assessment of Additional Franchise Tax*

Comcast’s California franchise tax returns for 1998 and 1999 were filed on a combined report basis and included the incomes and apportionment factors of Comcast Corporation and approximately 200 of its majority-owned subsidiaries.² QVC and

² Comcast Cablevision Corporation of California filed the California unitary group tax returns for the years at issue, as well as the claims for refund, as the “key corporation” for the combined reporting group. (See Cal. Code Regs., tit. 18, § 25106.5, subd. (b)(14).) ComCon Production Services I, Inc., the plaintiff in the refund action and respondent and cross-appellant

QVC's subsidiaries were not included in those combined reports. (QVC filed its own combined reports during the entire period it was majority owned by Comcast, including the two years at issue in this litigation.) Comcast also did not include in its 1999 return any of the \$1.5 billion contract termination fee it received as a result of MediaOne's election, pursuant to its merger agreement with Comcast, to merge with AT&T Corporation rather than Comcast.

The Board audited Comcast's 1998 and 1999 returns and concluded Comcast had underreported its California source income and tax liabilities by failing to compute its tax liabilities on a unitary basis with QVC and by not including the contract termination fee. In September 2005 the Board issued Notices of Proposed Assessment of \$933,142 for 1998 and \$11,300,834 for 1999, as well as additional tax, interest and penalties based upon adjustments made during the audit.

Comcast protested the proposed deficiencies and filed an appeal with the State Board of Equalization (SBOE). In a decision on February 2, 2012 the SBOE upheld the Board's determination that Comcast and QVC were a unitary business and that the MediaOne termination fee was business income.

Comcast made a payment for tax, interest and penalties of \$27,674,977.07 in May 2012 and an additional payment of \$23,754.36 in June 2012 based on supplemental assessments. It thereafter filed claims for refund of those sums, which the Board denied.

in this court, is the successor-in-interest to Comcast Cablevision Corporation of California.

2. Comcast's Lawsuit

Comcast filed a complaint for refund of corporation tax on August 6, 2012, asserting in separate causes of action that Comcast and QVC were not a single unitary business during the two tax years at issue and that the MediaOne termination fee constituted nonbusiness income. It sought a total refund of tax, interest and penalties of \$27,698,731.43.

A 19-day bench trial took place over two months (September 25 through November 18, 2013). The evidence included testimony from 17 witnesses, including executives from Comcast and QVC and experts on the economics of the cable industry and state tax policy, and extensive documentary exhibits that were admitted into evidence. Each party submitted both trial and closing briefs.

On March 6, 2014 the court orally announced its decision, finding in favor of Comcast on the QVC unity issue, ruling there was insufficient evidence of centralized management, functional integration and economies of scale or other significant flows of value between Comcast and QVC and adopting the argument in Comcast's closing brief on those points. However, the court found the Board was substantially justified in applying a contribution or dependency test for unity and in concluding there was evidence to aggregate the two companies for tax purposes and, accordingly, denied Comcast's request for attorney fees on that issue. The court then found the MediaOne termination fee was business income and was appropriately taxed as such, adopting as its ruling in favor of the Board on this issue portions of the Board's closing brief.

The court suggested, and the parties agreed, the court's statement of decision would consist of the portions of the closing briefs cited by the court in ruling on the two causes of action.

The statement of decision was filed April 7, 2014. Judgment was entered August 22, 2014 awarding Comcast on the first cause of action \$2,833,671.31 plus postjudgment interest for the 1998 tax year and nothing with respect to the 1999 tax year, and ordering as to the second cause of action that Comcast take nothing from the Board.³ Comcast was subsequently awarded slightly more than \$140,000 in costs pursuant to Code of Civil Procedure section 685.090.

FACTUAL BACKGROUND

1. The QVC Unity Issue

a. The business of Comcast and QVC

Comcast, founded by Ralph Roberts, began operations by acquiring a 1,200-subscriber cable system (then called community antenna television) in Tupelo, Mississippi, in 1963. In the following years Comcast grew by building new systems in areas that did not have their own cable systems, acquiring existing cable systems from other companies and adding subscribers to its systems. By the end of 1998 Comcast was the fourth largest cable system operator in the United States with approximately 4.5 million subscribers. By year-end 1999

³ According to the Board's computations if, as the trial court ultimately ruled, the MediaOne termination fee was business income and Comcast and QVC could not be taxed as a unitary business, Comcast's tax liability for 1999 would increase beyond the amount the Board had assessed. Accordingly, the judgment awarded no refund to Comcast for 1999 even though it had been improperly taxed on a unitary basis with QVC in both 1998 and 1999.

Comcast had 5.6 million subscribers and was the third largest cable operator in the country.⁴

During the relevant time period Comcast generated much of its revenue through the sale of video subscription services for television channels to residential subscribers in various packages, which could include premium channels (for example, HBO), basic cable channels (for example, ESPN and the Disney channel) and local broadcast stations (for example, local over-the-air affiliates for ABC, CBS, FOX, and NBC). Comcast generally negotiated carriage agreements with content providers and paid licensing fees to obtain their programming.

QVC, founded by Joseph Segel in 1986, is a home shopping network (similar to its competitor The Home Shopping Network)—an electronic retailer selling consumer products and services by way of televised channels and, more recently, over the Internet. Segel was chairman and chief executive officer of QVC from 1986 until he retired in 1993. His successor as chief executive officer was Barry Diller, a prominent entertainment industry executive who had served as chairman and chief executive officer of Paramount Pictures Corporation and Fox, Inc.

QVC's annual sales rose from slightly over \$100 million in its first year of operations to more than \$2.4 billion by 1998. Unlike most entertainment programming content providers, rather than receiving license fees for its programming, QVC, like other home shopping networks, pays cable operators to carry its channels, typically 5 percent of net sales to the cable operator's subscribers.

⁴ In 2002 Comcast became the largest cable television company in the United States by acquiring the assets of AT&T Broadband.

b. *Comcast's investments in QVC*

Comcast purchased QVC stock in QVC's September 1986 initial public offering, as did approximately 25 other cable companies. (Cable operators were able to buy Class B shares for \$0.20/share coupled with a commitment to carry the station and guarantee a minimum number of subscribers. Class B shares were convertible under certain circumstances to Class A shares, which were sold to the public for \$10/share. QVC had the right to reacquire Class B shares if the cable operator failed to carry its channel.) Comcast acquired 14.3 percent of QVC's stock, the maximum number permitted in the public offering, becoming QVC's largest shareholder after Segel and his wife.

Over the next several years Comcast increased its ownership of QVC stock as part of QVC's incentive programs to encourage cable companies to extend their carriage agreements or increase the number of cable subscribers under existing agreements. An additional equity investment resulted from a \$30 million convertible subordinated loan from Comcast to QVC in 1989 as part of QVC's financing to acquire one of its largest competitors, the Cable Value Network. As of mid-1994 Comcast owned approximately 15 percent of QVC.

The carriage agreement between Comcast and QVC provided that Comcast would distribute QVC on an exclusive basis (except as might be required by preexisting agreements), QVC would pay Comcast the highest rate of consideration paid to any other cable operator and QVC would consult with Comcast as to the content and presentation of its programming. The agreement also contained a "most favored nations" clause that assured Comcast would continue to receive terms at least as favorable as comparable terms offered to any other cable system operator. (Certain of QVC's agreements with other cable

operators contained similar provisions.) In its 1986 annual report Comcast described its investment in QVC as part of its effort to become involved in program development, not just distribution.

c. Comcast's tender offer for QVC

In 1993 Diller, now QVC's chief executive officer, with Comcast's support, made an unsuccessful attempt to acquire Paramount Communications, the parent of Paramount Pictures—an acquisition that was consistent with QVC's (and Comcast's) goal of expanding its programming business. Shortly after losing the Paramount takeover battle to Viacom in 1994, Diller proposed a merger between QVC and CBS, Inc. Because of Federal Communications Commission rules then in effect, Comcast could not have owned more than a 5 percent voting interest in the merged entity, which would continue to include the broadcast network; and its role would be limited to that of a passive investor.

Comcast opposed the CBS merger proposal and the prospect of having to sell its investment. As an alternative, the Comcast board authorized a tender offer to QVC's public shareholders for all outstanding shares of QVC. Liberty Media Corp., another QVC shareholder (and the controlling owner of the Home Shopping Network), then joined with Comcast in its bid to acquire complete ownership of QVC. The tender offer was structured so that Comcast's ownership in QVC increased to 57 percent with Liberty owning the remaining 43 percent of the company. QVC's shareholders accepted the tender offer, and the sale was consummated in early 1995. Comcast and Liberty remained joint owners through 2003, but the two companies entered into a shareholders' agreement in early 1995 under which Liberty relinquished its right to participate in the

management of QVC, including the right to appoint members to the QVC board of directors.⁵ Thus, during the tax years at issue here, 1998 and 1999, Comcast owned 57 percent of QVC's stock but enjoyed exclusive rights with respect to its management.

d. *The relationship between Comcast and QVC during Comcast's years as majority owner*

Upon becoming majority owner of QVC, Comcast appointed four of its top executives, including Ralph Roberts, Comcast's chairman and chief executive officer, and his son Brian Roberts, then Comcast's president, to QVC's board of directors. Comcast senior executives comprised the entirety of the QVC board from 1995 until 2003.

Shortly after the Comcast-Liberty tender offer, Diller resigned as CEO of QVC. At Segel's suggestion Brian Roberts met with Douglas Briggs, then QVC's president of electronic retailing, about replacing Diller. According to Briggs, at the conclusion of their meeting the two men agreed "that as President and CEO of the company, when the deal went through, that I would have the freedom to run the company as I saw fit." Roberts's trial testimony was substantially the same: He gave Briggs the autonomy he had asked for as part of their agreement for Briggs to assume his new role at QVC. Briggs confirmed that Roberts and Comcast honored this commitment throughout the period it was QVC's majority shareholder: Day-to-day operations of QVC's business were conducted by QVC management personnel without direction and independently from Comcast.

⁵ Liberty exercised exit rights granted by the stockholders' agreement and purchased Comcast's stock in QVC in March 2003.

Despite this independence, Briggs and QVC's chief financial officer William Costello met regularly with Brian Roberts to discuss QVC's financial information. Costello testified Comcast had access to whatever financial data it wanted, and QVC executives reported on QVC business at Comcast board meetings. Although QVC advised Comcast about its plans for expansion, investments and expenditures, Briggs, Costello, Roberts and others testified that Briggs and his management team at QVC made its major strategic decisions, including, for example, expansion of international operations and construction of a new warehouse in North Carolina, without involvement or approval from Comcast.

Throughout these years Comcast and QVC maintained separate headquarters; each operated its own call centers and warehouses; and they retained separate departments responsible for the operations of their business, including back-office and administrative functions although QVC's internal audit function was conducted by Comcast personnel. Comcast did occasionally use QVC facilities (described as "excess studio capacity") to produce programming distributed to Comcast subscribers, and the entities jointly obtained insurance coverage to secure preferential volume pricing.

In addition to Comcast's ownership of a majority of QVC's stock, there was a significant, ongoing business relationship between the companies during the years at issue: Approximately 10 percent of the total homes reached by QVC in this period were attributable to its contracts with Comcast to carry the QVC network on its cable systems. Comcast received what it denominated as "service income" from QVC of \$13.3 million in 1998 and \$10.4 million in 1999, principally from the 5 percent commission QVC paid for sales attributable to Comcast cable

subscribers with the balance attributable to launch incentives and payments for favorable channel placement.

According to Comcast's witnesses the terms under which cable operators carried home shopping channels were standardized across the industry: The 5 percent commission was a market-standard rate first established years earlier by the Home Shopping Network. The carriage agreement between Comcast and QVC in effect in 1998 and 1999 had been entered in 1994 before Comcast acquired its majority ownership interest in QVC and contained substantially the same terms as had been offered to other cable operators.⁶ Negotiations for a renewal of that agreement, which expired in 2001, began in 1999 and were described by the Comcast and QVC negotiators as arm's length and hard-fought. Each executive was attempting to obtain the best possible deal for his employer.

2. The MediaOne Termination Fee Issue

Comcast's fundamental business strategy emphasized growth through acquisition of other cable companies: At year-end 1999 Comcast had six significant transactions in process for the acquisition of full or partial interests in other cable entities, and it had plans to nearly double its cable subscriptions through acquisitions and service-area swaps by the end of 2000. The company employed a full time staff dedicated to investigating and analyzing potential acquisitions and developing the financing needed to take advantage of expansion opportunities.

⁶ The 1994-2001 carriage agreement was admitted into evidence under seal, and testimony by the QVC executive responsible for negotiating the company's carriage agreements was also taken under seal.

On March 22, 1999 Comcast and MediaOne entered into a merger agreement. Although MediaOne was the larger company—at the time it was the third largest cable system operator in the United States with approximately five million domestic cable subscribers—the agreement provided for Comcast to acquire MediaOne. The Comcast-MediaOne merger agreement permitted MediaOne to entertain unsolicited superior proposals; but, if such a proposal was accepted, MediaOne was obligated to pay Comcast a termination fee of \$1.5 billion.

On May 1, 1999 MediaOne notified Comcast it had accepted an acquisition offer from AT&T. On May 4, 1999 Comcast announced it would not enter into a bidding war and make a further offer for MediaOne. Instead, Comcast and AT&T reached an agreement, contingent in large part on a successful merger of AT&T and MediaOne, to exchange various cable systems. On May 6, 1999 MediaOne terminated the merger agreement with Comcast and paid the termination fee to one of its wholly owned subsidiaries (Comcast Investment Holdings, Inc., a Delaware corporation, to which the rights to the termination fee had been assigned). The proceeds from the termination fee were used to reduce Comcast's business-related corporate debt.

In a refund claim/amended 1999 federal tax return Comcast took the position the termination fee was not ordinary income and could be used to reduce the tax basis for various corporate assets held by the parent company and its subsidiaries—a position ultimately rejected by the Internal Revenue Service. Comcast did not report the termination fee as business income on its unitary group return in California or as nonbusiness income in Delaware, the commercial domicile of Comcast Investment Holdings, Inc. According to Comcast, the subsidiary was exempt from Delaware income tax (and free from

any reporting requirement) because its activities in the state were limited to the maintenance and management of intangible investments, which are not taxable in Delaware.

DISCUSSION

1. *Standard of Review*

The proper application of tax statutes and case law to a specific set of facts—here, the determination whether Comcast and QVC should be classified as a unitary business for tax years 1998 and 1999 for purposes of section 25101 and whether the MediaOne termination fee was business income within the meaning of section 25120—is subject to de novo review by this court. (See *Northrop Grumman Corp. v. County of Los Angeles* (2005) 134 Cal.App.4th 424, 429 [“classification of items as taxable or nontaxable presents a question of law that is reviewed independently on appeal”]; *A.M. Castle & Co. v. Franchise Tax Bd.* (1995) 36 Cal.App.4th 1794, 1801 (*A.M. Castle*); *Tenneco West, Inc. v. Franchise Tax Bd.* (1991) 234 Cal.App.3d 1510, 1520-1521 (*Tenneco West*); see generally *Crocker National Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881, 888 [whether an individual computer component represents a “fixture” for property-tax purposes must be reviewed independently on appeal; “the pertinent inquiry bears on the various policy considerations implicated in the solution of the problem of taxability, and therefore requires a critical consideration, in a factual context, of legal principles and their underlying values”].)

Many of the facts here are undisputed. Nevertheless, to the extent there are disputed issues of fact material to the resolution of the two issues presented, we review the trial court’s factual findings under the substantial evidence standard. (*A.M.*

Castle, supra, 36 Cal.App.4th at p. 1801; *Tenneco West, supra*, 234 Cal.App.3d at p. 1521.)

2. *The Trial Court Correctly Determined Comcast and QVC Were Not Unitary*

In its statement of decision the trial court described as “overwhelming” the evidence that none of the three “hallmarks” of a unitary relationship—“centralization of management, functional integration and economies of scale”—was present as a result of Comcast’s ownership of QVC. The same evidence, the court found, established the absence of any unity of use or unity of operation.

The Board challenges this ruling, arguing primarily that the trial court erred by failing to analyze the evidence under the dependency or contribution test, which the Board had used as the basis for its determination that Comcast and QVC were a unitary business enterprise, instead applying a more limited three-factor (or three hallmarks) test first articulated by the United States Supreme Court in *Mobil Oil Corp. v. Commissioner of Taxes* (1980) 445 U.S. 425 [100 S.Ct. 1223, 63 L.Ed.2d 510] (*Mobil Oil*). Comcast counters that the trial court considered not only the *Mobil Oil* test but also the three unities and dependency or contribution tests, that substantial evidence supports its factual findings, and that, based on those findings, the trial court correctly concluded Comcast and QVC were not unitary under any governing legal tests.⁷ We agree with each aspect of Comcast’s argument.

⁷ Comcast also contends the Board forfeited any right to contest the trial court’s findings because it failed to fairly summarize all of the material evidence in its opening brief, citing only to testimony and documents supporting its position. (See

a. *The applicable legal standards for whether a unitary business exists*

In *Mobil Oil, supra*, 445 U.S. 425, the Supreme Court considered the constitutional limits under the Due Process and Commerce Clauses of the United States Constitution to a state's taxation under the apportionment method of dividend income from subsidiaries and affiliates doing business outside the country. Upholding Vermont's taxation of a portion of Mobil's foreign enterprise dividend income, the Court held, from a constitutional perspective, the form in which the income was received was insignificant: "So long as dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business. One must look

Foreman & Clark Corp. v. Fallon (1971) 3 Cal.3d 875, 881 [appellants are "required to set forth in their brief *all* the material evidence on the point and *not merely their own evidence*. Unless this is done the error is deemed to be waived"]; *Schellinger Brothers v. Cotter* (2016) 2 Cal.App.5th 984, 998 ["a party challenging the sufficiency of the evidence to support a factual determination made by the trier of fact is *required* to set out *all* evidence pertinent to that determination, on penalty of forfeiting review"]; see also Cal. Rules of Court, rule 8.204(a)(2)(C) [appellant's opening brief must "[p]rovide a summary of the significant facts limited to matters in the record"].) The Board insists it seeks de novo review of the trial court's application of an incorrect legal standard to undisputed facts. Although Comcast's characterization of the Board's challenge to the unitary business ruling appears more accurate, we elect to disregard any noncompliance with procedural rules, utilizing the factual recitation in Comcast's respondent's brief to supplement the Board's, and reach the merits of the parties' arguments. (See Cal. Rules of Court, rule 8.204(e)(2)(C).)

principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability.” (*Id.* at p. 440.)

In reiterating that “the linchpin of apportionability in the field of state income taxation is the unitary-business principle” (*Mobil Oil, supra*, 445 U.S. at p. 439), the Court explained it had repeatedly rejected the contention that income earned in one state may not be taxed in another if the source of the income may be ascertained by separate geographical accounting “so long as the intrastate and extrastate activities formed part of a single unitary business.” (*Id.* at p. 438.) “In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.” (*Ibid.*)

Twenty-eight years after *Mobil Oil*, in *MeadWestvaco Corp. v. Illinois Dept. of Revenue, supra*, 553 U.S. 16, the Supreme Court reviewed its several decisions discussing the unitary business principle and stated, in remanding the case to the Illinois appellate courts to determine whether that principle had been properly applied by the state trial court, “Where, as here, the asset in question is another business, we have described the ‘hallmarks’ of a unitary relationship as functional integration, centralized management, and economies of scale.” (*Id.* at p. 30; see *Allied Signal, Inc. v. Director* (1992) 504 U.S. 768, 789 [112 S.Ct. 2251, 119 L.Ed.2d 533] “[t]he hallmarks of an acquisition that is part of the taxpayer’s unitary business continue to be functional integration, centralization of management, and economies of scale”]; see also *Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159, 179 [103 S.Ct. 2933, 77 L.Ed.2d 545]

[“a relevant question in the unitary business inquiry is whether “contributions to income [of the subsidiaries] [resulted] from functional integration, centralization of management, and economies of scale””].) However, the *MeadWestvaco* Court also observed, quoting from its earlier opinions, that “any number of variations on the unitary business theme are logically consistent with the underlying principles motivating the approach.” (*MeadWestvaco*, at p. 28, internal quotation marks omitted; see *Container Corp.*, at p. 178, fn. 17 [“there is a wide range of constitutionally acceptable variations on the unitary business theme”]; see also *Honolulu Oil Corp. v. Franchise Tax Bd.* (1963) 60 Cal.2d 417, 425 [“[t]his court is under no compulsion to employ the identical tests approved by the Supreme Court as to other states’ statutes, as long as the test so employed in this state does not infringe constitutional rights”].)

Our colleagues in Division Four of this court, in *Mole-Richardson Co. v. Franchise Tax Bd.* (1990) 220 Cal.App.3d 889, recognized that the three factors enumerated in *Mobil Oil* were, in essence, simply a different formulation of the same basic tests long utilized in California to determine whether a unitary business existed: “Appellant’s position seems to be based on the view that ‘functional integration’ [as used in United States Supreme Court cases] refers to a new and different concept with which a business enterprise must be evaluated to justify unitary treatment. Although the term is not specifically defined in the cases cited, a review of the analyses employed makes it clear that the determinative factors are the same as set forth in title 18, California Code of Regulations, section 25120, as well as in the earlier California cases [citations]. Those factors are ‘strong central management, coupled with the existence of centralized departments for such functions as financing, advertising,

research, or purchasing’ [citation] and ‘unity of ownership’; ‘unity of operation as evidenced by central purchasing, advertising, accounting and management divisions’; and ‘unity of use in its centralized executive force and general system of operation.’” (*Mole-Richardson*, at p. 899.)

The trial court here acknowledged the Supreme Court in *Mobil* used slightly different terminology from the three unities test applied in California case law and then correctly ruled, consistent with the *Mole-Richardson* analysis, “the two tests look to the same basic factors.” Both tests, the court continued, “attach primary importance to centralized management (unity of use) and functional integration (unity of operation).” The court applied both tests in evaluating the evidence and also fully considered the Board’s contention that, apart from the questions of centralized management and operational integration, “flows of value existed that justify the forcible combination of Comcast and QVC”—an acceptable alternate description of the dependency or contribution test urged by the Board. (See *A.M. Castle, supra*, 36 Cal.App.4th at p. 1806 “[w]e may constitutionally apply any test to determine unity as long as there is ‘a flow of *value*’ between the segments which make up a unitary business”]; see also *Container Corp. v. Franchise Tax Board, supra*, 463 U.S. at p. 178 “[t]he prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value*, not a flow of goods”].) Indeed, the trial court specifically noted the same evidence that demonstrated a lack of unity of the two companies under a functional integration analysis was equally sufficient to establish the absence of any “contribution or dependency.”

In sum, as reflected in its statement of decision, the trial court fully understood the governing federal and state case law that described three closely related approaches for analyzing

whether Comcast and QVC were appropriately considered a unitary business for the two tax years at issue. As discussed in the following section, substantial evidence supports the court's findings with respect to disputed factual issues. Based on those findings, the trial court correctly concluded, properly applying those legal principles, that QVC did not engage in a unitary business with Comcast—that, although commonly owned, the entities were not integrated in a way that transferred value between them.

b. *Substantial evidence supports the trial court's findings*

Defending its determination that Comcast and QVC engaged in a unitary business during the years at issue, the Board presented evidence the two companies were vertically integrated; Comcast appointed the members of the QVC board, all of whom were senior Comcast executives, and had held itself out as being involved in a mutually beneficial and interdependent relationship with QVC in its public statements; and there were many intercompany activities, including intercompany sales, joint marketing efforts and shared use of corporate resources.

As to the first point, the Board presented testimony that cable television distributors need programming and cable programmers need distributors. Because Comcast and QVC were commonly owned, their supplier-distributor relationship constituted vertical integration, which, under the Board's regulations, created a strong presumption of unity. (See Cal. Code Regs., tit. 18, § 25120, subd. (b)(2) [that activities of a taxpayer are steps in a vertical process is a strong indicator the taxpayer is engaged in a single trade or business].)

Comcast, in contrast, introduced expert testimony that Comcast and QVC were not vertically integrated and, in fact,

were in entirely different businesses (cable broadcasting and retailing of consumer products). Unlike conventional entertainment content providers who receive licensing fees from cable distributors for the right to transmit their productions to cable subscribers, QVC paid Comcast and other cable companies to carry its home shopping programs, effectively renting space on the cable systems for a market-standard 5 percent commission rate. Several witnesses testified that QVC did not provide programming in the traditional sense although the accuracy and significance of that testimony was disputed. In addition, QVC's carriage agreement with Comcast contained terms offered to all other major cable distributors, according to Comcast's expert, who also testified, although the carriage agreement constituted a significant intercompany transaction, Comcast and QVC were not economically dependent on one another and no economies of scale were achieved because of Comcast's majority ownership of QVC. (Cf. *Allied Signal, Inc. v. Director*, *supra*, 504 U.S. at p. 789 ["transactions not undertaken at arm's length" between parent and subsidiary constitute evidence of a unitary business and an uncompensated "flow of value"].)

On the issue of overlap between the companies' management structures, the undisputed evidence demonstrated that Comcast undoubtedly had the ability to exert significant management influence and control over QVC's major policy decisions. However, as discussed, Comcast's and QVC's CEOs during the years in question testified QVC's business—both its major strategic decisions and the day-to-day operations—was conducted by QVC management personnel without direction from Comcast. (See *Allied Signal, Inc. v. Director*, *supra*, 504 U.S. at p. 781 ["although the parent company had the potential to operate the subsidiaries as integrated divisions of a single

unitary business, that potential was not significant if the subsidiaries in fact comprise discrete business operations”]; compare *Tenneco West*, *supra*, 234 Cal.App.3d at p. 1528 [based on evidence in the record, “trial court could reasonable find Tenneco’s degree of centralized management was not strong but instead simply evidenced such corporate activities as would exist in most parent-subsidiary relationships”] with *A.M. Castle*, *supra*, 36 Cal.App.4th at p. 1806 [“Unity of use exists where one corporation controls another corporation with respect to major policy matters at the highest levels. [Citations.] Castle clearly had that opportunity—and apparently exercised it—with respect to Hy-Alloy”].) Although some Comcast executives were given assistant officer titles at QVC, testimony from Comcast established those individuals served no operational function (the positions were described as “purely ministerial”). In fact, there were no transfers of personnel between the two companies.

The Board also introduced Comcast annual reports in which the company referred to QVC as one of its “key franchises” and a “core” operation and described its investment in QVC as designed to help satisfy Comcast’s “growing need for new and better products for [its cable] subscribers.” Similarly, QVC was termed “a Comcast springboard for developing communications content.” Thus, the Board argues, Comcast itself acknowledged that QVC operationally contributed to Comcast’s cable business and was not simply an unrelated, passive investment by Comcast.

Comcast, on the other hand, emphasized that the nature of its association with QVC remained essentially the same from the time QVC was formed in 1986: There was no material change in 1995 when Comcast became the majority owner of QVC or in 1998 and 1999, the tax years at issue. While the two companies

had an operational relationship from the outset, at no time, Comcast's evidence demonstrated, was there any functional integration of the operations of the two entities. For example, although there were isolated instances when Comcast used QVC facilities, the two companies owned, maintained and operated separate headquarters, warehouses and call centers. Similarly, although Comcast for a time assisted with certain limited QVC promotional efforts, Comcast's participation in these activities was not materially different from that of other cable distributors with QVC carriage agreements. Throughout the period of Comcast's ownership of QVC stock, moreover, Comcast and QVC maintained entirely independent marketing departments. Finally, while there was undisputed evidence of joint purchase of some insurance products for Comcast and QVC, there was no attempt to consolidate back-office or administrative departments; and the evidence the entities shared legal or other outside expenses or engaged in any significant degree of intercompany financing was contested.

As the trial court ruled when denying Comcast's request for attorney fees, the conflicting evidence of the ongoing Comcast-QVC relationship, viewed in the aggregate, could reasonably be found to establish a unitary business under the general dependency or contribution test (that is, QVC operationally contributed to Comcast's cable business, and Comcast operationally contributed to QVC's home shopping business). But it was equally reasonable to resolve the disputed factual issues as the trial court did. Those findings, supported by substantial evidence, established that Comcast and QVC were not vertically integrated, lacked a centralized management, generated no economies of scale and produced no other flow of values that justified the Board's treatment of their tax liabilities on a

consolidated basis for the two years at issue. Based on those findings, we agree with the trial court’s conclusion that Comcast and QVC were not integrated with each other and neither company was dependent upon or contributed to the other within the meaning of the legal standards for determining a unitary business. (See Cal. Code Regs., tit. 18, § 25120, subd. (b).)

3. *The Trial Court Correctly Determined the Termination Fee Constituted Business Income*

a. *The termination fee satisfies the transactional test*

As discussed, under California’s version of UDITPA (§ 25120), corporate income is properly classified as “business income” subject to apportionment if it satisfies either a “transactional” or a “functional” test. (*Hoechst Celanese, supra*, 25 Cal.4th at p. 526.)⁸ Under the former we identify the transaction or activity that gave rise to the income and determine whether that transaction or activity arose “in the regular course of the taxpayer’s trade or business.” (§ 25120, subd. (a); see *Hoechst Celanese*, at p. 526.) “‘The controlling factor by which’ the transactional test ‘identifies business income is the nature of the particular transaction’ that generates the income. [Citation.] To create business income, these ‘transactions and activity’ must occur ‘in the *regular* course of the taxpayer’s trade or business.’ [Citation.] ‘[R]elevant considerations include the frequency and regularity of similar transactions, the former practices of the business, and the taxpayer’s subsequent use of the income.’ [Citation.] ‘[U]nprecedented . . . once-in-a-corporate-lifetime

⁸ “For purposes of administration of [UDITPA], the income of the taxpayer is business income unless clearly classifiable as nonbusiness income.” (Cal. Code Regs., tit. 18, § 25120, subd. (a).)

occurrence[s]’ do not meet the transactional test because they do not occur in the regular course of any business. [Citation.] Thus, income arising from ‘extraordinary’ events such as a ‘complete liquidation and cessation of business’ cannot satisfy the transactional test.” (*Id.* at pp. 526-527.)

The \$1.5 billion contract termination fee at issue here was paid to Comcast pursuant to the terms of the MediaOne merger agreement, which provided Comcast with the right to acquire MediaOne or to receive the termination fee if MediaOne unilaterally elected not to complete the transaction. The trial court found, and Comcast does not dispute, that Comcast had engaged in scores of cable acquisition transactions over the years as a regular part of its business—transactions that, although smaller in scope, were of the same basic nature as the MediaOne agreement. Nonetheless, relying on language in *Hoechst Celanese*, *supra*, 25 Cal.4th 508, Comcast contends the trial court, like the Board, improperly focused on the asset that gave rise to the income—a cable company acquisition agreement—rather than the transaction or activity that actually generated the income, the termination of the merger agreement, which Comcast contends was an extraordinary, once-in-a-corporate lifetime event for Comcast.⁹ The Supreme Court’s analysis in *Hoechst Celanese* does not support Comcast’s position.

⁹ The nature of the asset, Comcast explains, is the proper focus of the functional test, which examines whether the acquisition and use of the income-producing property constituted an integral part of the taxpayer’s regular business operations. (§ 25120, subd. (a); *Hoechst Celanese*, *supra*, 25 Cal.4th at p. 532.) Because the MediaOne merger agreement was never completed and the MediaOne cable systems were never owned by Comcast or used in its business to produce income, Comcast argues, the

In *Hoechst Celanese* the Supreme Court considered whether a reversion of surplus pension plan assets to an out-of-state corporation that conducted business operations in California was properly considered by the Board to be apportionable business income. The corporation maintained a pension plan for the general benefit of its employees. (*Hoechst Celanese, supra*, 25 Cal.4th at p. 513.) The plan covered both active and retired employees; each plan member had a right to a predefined level of benefits. (*Id.* at pp. 513-514.) To fund the pension plan, the corporation made periodic contributions to a tax exempt trust it had created, which was responsible for investing those sums. Any surplus assets in the trust as a result of sound investment decisions—that is, sums in excess of those necessary to meet the corporation’s legal obligations under the terms of the plan and federal law—were used to reduce future contributions, not to increase benefits. (*Id.* at p. 514.) The corporation exercised control over the pension plan and its assets through various administrative and oversight committees composed of its officers and employees. (*Id.* at pp. 514-515.) Although the corporation did not own or hold legal title to the assets in the trust, any surplus assets reverted to the corporation upon termination of the plan and satisfaction of all benefits and liabilities owed. (*Id.* at p. 514.)

In 1983 the corporation divided the pension plan into two plans, one for retired employees and one for active employees, and similarly divided the trust into two separate trusts, each with sufficient funds to provide all benefits owed to the respective

termination fee cannot constitute business income under the functional test. We need not, and do not, evaluate Comcast’s argument on this point.

plan's members. (*Hoechst Celanese, supra*, 25 Cal.4th at p. 515.) The trust linked to the plan for retired employees then purchased annuities to fully provide all benefits owed to retirees, and in 1985 the corporation terminated the retiree pension plan and related trust. As a result, approximately \$388.8 million in surplus assets reverted to the corporation, which placed the assets in its general fund to be used for general corporate purposes. (*Id.* at p. 516.) The corporation paid New York state income tax on a portion of the reverted income, but did not apportion any part of the reverted income to California. (*Ibid.*)

The Board assessed additional tax, and the corporation filed a claim for a refund. (*Hoechst Celanese, supra*, 25 Cal.4th at p. 516.) The trial court ruled for the Board; the court of appeal found in favor of the corporation. (*Id.* at p. 517.) The Supreme Court reversed the court of appeal's decision, holding the income from the reversion was not taxable under section 25120, subdivision (a)'s transactional test (*id.* at p. 526), but was taxable under the functional test because the income-producing property—the pension plan and trust—had been created to retain current employees and attract new ones; and the corporation had authority to amend the plan and exercised control over it, funded it with its business income, and retained an interest in the surplus plan assets. Thus, the Court concluded, acquisition, control and use of the income-producing property contributed materially to the taxpayer's production of business income. (*Id.* at p. 536.)

In holding the reverted income did not satisfy the transactional test, on the other hand, the *Hoechst Celanese* Court explained, “[T]he reversion and the activities necessary to execute the reversion were extraordinary occurrences. They were not normal trade or business activities of Hoechst” (*Hoechst*

Celanese, supra, 25 Cal.4th at p. 527.) The Court rejected the Board’s argument the relevant transactions were the purchase and sale of securities by the fund managers appointed by the corporation, pointing out that those investments did not result in any taxable income to the corporation and reiterating “the only transaction or activity that generated any taxable income for Hoechst was the reversion itself.” (*Ibid.*)

Arguing the trial court erred in holding the termination fee it received from MediaOne was business income under the transactional test, Comcast insists termination of the merger agreement, like termination of the retirees’ pension plan in *Hoechst Celanese*, was the pertinent activity for purposes of the transactional test, not the negotiation or execution of the MediaOne merger agreement. Although cable company acquisitions were a regular part of its business, Comcast continues, receipt of a termination fee—the only income generating activity—was an extraordinary, once-in-a-corporate-lifetime occurrence.

Comcast’s reliance on *Hoechst Celanese* is misplaced. Payment of the \$1.5 billion termination fee was a bargained-for, direct result of Comcast’s agreement to acquire MediaOne through merger. That is, Comcast’s entry into the merger agreement was the activity that gave rise to the disputed termination fee income, just as “the activities necessary to execute the reversion” gave rise to the reversion of surplus pension plan assets to the corporation in *Hoechst Celanese*. (*Hoechst Celanese, supra*, 25 Cal.4th at p. 527.) The crucial difference between *Hoechst Celanese* and the case at bar is that the reversion and the activities necessary to effectuate it were extraordinary occurrences for Hoechst Celanese, while cable acquisition transactions, including the proposed MediaOne

merger, as Comcast has effectively conceded, occurred in the regular course of Comcast's business¹⁰—the controlling factor in applying the transactional test. (*Id.* at p. 526; see *Jim Beam Brands Co. v. Franchise Tax Bd.* (2005) 133 Cal.App.4th 514, 522.) In addition, as the trial court found, Comcast used the termination fee income to pay general business obligations, another significant consideration in identifying business income under the transactional test. (*Hoechst Celanese*, at p. 526.)

A strikingly similar situation was considered by the Oregon Supreme Court in *Pennzoil Co. v. Dep't of Revenue* (Or. 2001) 332 Or. 542 [33 P.3d 314] (*Pennzoil*).¹¹ The issue in the case was whether proceeds received in settlement of a tort judgment for intentional interference with a stock purchase/merger agreement was apportionable business income under the UDITPA provisions of Oregon's tax code. Pennzoil had agreed to purchase three-sevenths of Getty Oil's stock from the Getty Trust, with the balance continuing to be held by the Trust. The agreement, among other terms, provided Getty Oil's assets, including its oil and gas reserves, would be divided between Pennzoil and the

¹⁰ The Board introduced evidence that Comcast treated the expenses incurred in pursuing cable system acquisitions as business expenses, not nonbusiness expenses.

¹¹ Out-of-state authority is particularly useful in this analysis because, "when interpreting the UDITPA, we will strive to achieve uniformity with sister states when possible." (*General Motors Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 773, 788; accord, *Hoechst Celanese*, *supra*, 25 Cal.4th at p. 526; see § 25138 [the UDITPA portion of the Revenue and Tax Code "shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it"].)

Trust if the two shareholders could not agree on a restructuring plan for the company. (*Id.* at p. 544.)

Shortly after the Pennzoil-Getty agreement was signed, the Trust sold all of the Getty Oil stock to Texaco. After losing a lawsuit for specific performance against the Trust in Delaware, Pennzoil sued Texaco in Texas for tortious interference with the contract. A jury awarded Pennzoil more than \$11.1 billion in damages; Texaco filed for Chapter 11 bankruptcy protection; and Pennzoil ultimately accepted \$3 billion in satisfaction of the outstanding judgment. (*Pennzoil, supra*, 332 Or. at p. 544.) The Internal Revenue Service agreed to treat a portion of the settlement proceeds as exempt from taxation as income received from an involuntary conversion, but ruled approximately \$2.1 billion was taxable income for 1988. Pennzoil, which only operated a facility to blend, package and distribute motor oil and related automotive products in Oregon, treated the settlement proceeds as nonbusiness income for purposes of its 1988 Oregon state tax return. (*Id.* at p. 545.) The Oregon Department of Revenue disagreed and assessed an additional corporate excise tax under Oregon's UDITPA apportionment principles. (*Ibid.*)

The Oregon Tax Court upheld the Revenue Department's ruling the proceeds were business income subject to apportionment under UDITPA. (*Pennzoil Co. v. Department of Revenue* (Or. Tax Ct. 2000) 15 Or.Tax 101.) The Oregon Supreme Court affirmed.¹² Citing *Hoechst Celanese*, among other cases,

¹² The trial court, adopting this portion of the Board's closing brief, cited the Oregon Tax Court's opinion in *Pennzoil*, not the Oregon Supreme Court's decision affirming the lower court. In its briefs in this court, Comcast argues the Oregon Tax Court's reasoning is inconsistent with *Hoechst Celanese*. That purported

the court explained the first question in applying the transactional test for determining business income was, “What transaction or activity gave rise to the disputed income?” (*Pennzoil, supra*, 332 Or. at p. 547.) The court rejected Pennzoil’s argument the settlement proceeds arose from Texaco’s tortious interference with the Pennzoil-Getty Trust contract. Rather, the court held, Pennzoil received the settlement proceeds “in lieu of its agreement with Getty,” thus, “the agreement gave rise to the disputed income.” (*Id.* at p. 548.)

Citing *Hoechst Celanese* once again, the Oregon Supreme Court then stated the second question to be addressed in applying the transactional test in this case was, “Did the agreement with Getty occur in the ‘regular course of [Pennzoil’s] trade or business?’” (*Pennzoil, supra*, 332 Or. at p. 548.) Pennzoil insisted it did not because the agreement was to acquire stock, an infrequent, unusual activity for the company. The Oregon Supreme Court rejected this characterization, explaining, although acquisition of stock in other companies, as here, may have been rare, “steps taken to acquire an interest in established oil reserves are steps taken in the ‘regular course of [Pennzoil’s] trade or business.’” (*Id.* at p. 549.)¹³

As in *Pennzoil*, in the case at bar Comcast and MediaOne’s agreement to merge is the activity that gave rise to the disputed

conflict, however, is nowhere to be found in the analysis of the Oregon Supreme Court, which Comcast does not address.

¹³ The Oregon Supreme Court also rejected Pennzoil’s claim that Oregon’s taxation of a portion of the settlement proceeds violated federal constitutional limits on a state’s taxation of multistate corporations. (*Pennzoil, supra*, 332 Or. at pp. 549-550.)

income, not the subsequent conduct that triggered the termination payment. And even more clearly than in *Pennzoil*, the proposed cable acquisition transaction with MediaOne occurred in the regular course of Comcast's business. Accordingly, the merger termination fee was properly classified by the Board as business income.

Comcast insists this analysis is flawed because, save for this singular instance, entering into acquisition agreements did not produce income for Comcast. Rather, income was only generated by integrating and then operating the acquired cable properties, activities that occurred well after any agreement was signed and performed. Again, Comcast mischaracterizes the transactional test as set forth in section 25120, subdivision (a), and explained in *Hoechst Celanese*. The relevant question is not whether the corporation earns income similar to that at issue in the regular course of its trade or business, but whether the activities that produced the income occurred in the regular course of its business. (*Hoechst Celanese, supra*, 25 Cal.4th at p. 527.) Entering into cable acquisition agreements was a regular part of Comcast's business, even if receipt of a termination fee was not; winding-up a pension plan, in contrast, was not a regular part of Hoechst Celanese's business.

b. *California's taxation of a portion of the termination fee is constitutional*

In addition to arguing the MediaOne merger termination fee falls outside section 25120's definition of business income, Comcast contends the Board's assessment of tax on any portion of that fee violates the Due Process Clause of the United States Constitution, which prohibits imposition of a state income tax on value earned outside the state's borders. (See, e.g., *ASARCO Inc. v. Idaho State Tax Comm'n* (1982) 458 U.S. 307, 315 [102 S.Ct.

3103, 73 L.Ed.2d 787].) As Comcast argues, “[T]here must be ‘some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.’” (*Hoechst Celanese, supra*, 25 Cal.4th at p. 538; accord, *Allied-Signal v. Director, supra*, 504 U.S. at p. 777.) Taxpayers challenging apportionment “must prove that ‘the income was earned in the course of activities unrelated to [those carried out in the taxing] State.’” (*Allied-Signal* at p. 787; accord, *Mobil Oil, supra*, 445 U.S. at p. 439.)

Here, California is taxing an apportioned share of income paid to Comcast in lieu of the benefits it would have received had the merger agreement been consummated—operating profits that would have been earned everywhere Comcast conducted its business, including California. Indeed, Comcast represented to its accountants (and subsequently to the Internal Revenue Service) that the MediaOne merger agreement was directly related to Comcast’s integrated nationwide business and the merger’s failure “touches and impacts the value of every aspect of Comcast’s business since each line revolves around cable.” No more “definite link” to California is needed to satisfy the constitutional requirements for taxing a portion of a multistate corporation’s business income.

c. *Comcast has forfeited its claim that recalculation of Comcast’s 1999 tax liability is required if the termination fee is held to be business income*

i. *The sales factor*

The business income of a multistate corporation is apportioned to California by multiplying its total business income by the apportionment factor—a statutorily defined fraction, “the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four.”

(§ 25128, subd. (a).) Those three included factors are also fractions designed to measure the portion of a taxpayer's property, payroll and sales properly attributable to California. The sales factor, which is at issue in this case, is a fraction defined as the total California sales during the taxable year divided by total company-wide sales. (§ 25134.)¹⁴ "Sales" for this purpose means "all gross receipts derived by the taxpayer from transactions and activity in the regular course of [the taxpayer's] trade or business." (Cal. Code Regs., tit. 18, § 25134, subd. (a)(1).) All gross receipts related to business income must be included in the denominator of the sales factor. (*Ibid.*)

If the standard apportionment and allocation provisions do not fairly represent the taxpayer's California business activity, the taxpayer may petition for, or the Board may require, use of an alternate approach. (§ 25137; see Cal. Code Regs., tit. 18, § 25137, subd. (a).) The party invoking the alternate procedure has the burden of proving by clear and convincing evidence that the standard formula does not produce a fair representation and the proposed alternative is reasonable. (*Microsoft Corp. v. Franchise Tax Bd.*, *supra*, 39 Cal.4th at p. 765; *General Mills, Inc. v. Franchise Tax Bd.* (2012) 208 Cal.App.4th 1290, 1300.)

ii. *Comcast's alternative request for recalculation of its 1999 sales factor*

In assessing additional tax for tax year 1999 the Board included the \$1.5 billion termination fee in Comcast's apportionable business income tax base but did not include the

¹⁴ Section 25134 provides, "The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales everywhere during the taxable year."

termination fee in the denominator of the sales factor. Instead, to determine the apportionment factor for Comcast and QVC as a unitary enterprise, the Board simply combined the apportionment factor amounts reported on Comcast's and QVC's 1998 and 1999 returns. Because Comcast had considered the termination fee to be nonbusiness income, it was not included in the apportionment factors it had used in its 1999 state return.

If the termination fee is properly considered apportionable business income, Comcast contends, it was error for the trial court to permit the Board to utilize this approach to calculate the 1999 sales factor. Absent exceptional circumstances, revenue that is part of the apportionable income base must be included in the sales factor denominator pursuant to section 25134. No exception is proper here, Comcast argues, because the Board had not demonstrated the standard apportionment provisions failed to fairly represent the extent of Comcast's activity in California as required by section 25137.

Comcast first presented the sales factor issue as a discrete matter after the evidentiary portion of the bench trial had concluded and the trial court issued its statement of decision. It was not specifically raised in Comcast's administrative tax refund claims, its superior court complaint for refund of corporation tax or its motion for summary adjudication of the termination fee issue. Comcast and the Board briefed the issue in memoranda of points and authorities in support of their respective proposed judgments.¹⁵ The court rejected both proposed judgments,

¹⁵ In assessing additional tax for 1999 on Comcast and QVC as a unitary business, but excluding the MediaOne merger termination fee from the sales factor denominator, the Board had applied a sales factor of 5.1389 percent. According to Comcast,

observing, “There was a lack of evidence at trial as to the tax computation to be applied, and both sides rested and agreed to the Statement of Decision.” The court ordered each side to lodge new proposed judgments.

Comcast’s next filing again proposed a judgment that would include the \$1.5 billion termination fee in the denominator of Comcast’s sales factor used to apportion Comcast’s apportionable business income, which, if applied, would result in a refund to Comcast for 1999 of slightly more than \$3 million. The court signed the Board’s revised proposed judgment, which did not provide for any adjustment of the sales factor and awarded Comcast nothing for 1999.

iii. *Comcast’s failure to timely challenge the sales factor used by the Board precludes this claim*

A taxpayer seeking a refund of tax improperly assessed must identify the specific grounds upon which the claim is based. Section 19322, subdivision (c), requires a claim for refund filed with the Board to “[s]tate the specific grounds on which the claim is founded.” Section 19382, in turn, provides, “[A]fter payment of

which provided sets of calculations with the posttrial memorandum in support of its proposed judgment, recalculating the sales factor to exclude QVC’s sales and include the termination fee in the sales factor denominator resulted in a sales factor of 6.6239 percent. The Board, in contrast, proposed decombining Comcast and QVC by eliminating the income and factors derived from QVC’s separately filed returns and reverting to the amounts initially reported by Comcast on its returns. Utilizing the sales factor numerator and denominator amounts on Comcast’s 1999 California tax return (which did not include the \$1.5 billion termination fee in the denominator), the sales factor utilized by the Board was 9.22355 percent.

the tax and denial by the Franchise Tax Board of a claim for refund, any taxpayer claiming that the tax computed and assessed is void in whole or in part may bring an action, upon the grounds set forth in that claim for refund, against the Franchise Tax Board for the recovery of the whole or any part of the amount paid.” The combined effect of sections 19322 and 19382 is that only grounds set out in a claim for refund may be the basis for a refund action. (See *Beatrice Co. v. State Bd. of Equalization* (1993) 6 Cal.4th 767, 772, fn.3 [applying parallel provisions regarding refund actions involving the SBOE].)

Acknowledging that neither its tax refund claims nor its complaint contained allegations regarding the sales factor used by the Board, Comcast asserts it was nonetheless entitled to raise the issue when it did because the trial court’s ruling on the QVC unity issue necessarily required a recalculation of Comcast’s tax liability for 1999, the year in which it received the MediaOne termination fee. That recalculation, Comcast argues, should use the standard apportionment rules, which require all gross receipts related to business income be included in the sales factor denominator.

Comcast’s attempt to justify its belated challenge to the Board’s exclusion of the termination fee from the 1999 sales factor denominator fails. The apportionment formula used by the Board to compute Comcast’s tax liability as a unitary business with QVC following its audit simply combined the apportionment factor amounts reported on Comcast’s and QVC’s original returns. As a result, the Board always included the termination fee in Comcast’s 1999 business income tax base but omitted it from the revised sales factor—an approach that would increase Comcast’s tax liability regardless of the outcome of the QVC unity issue. Accordingly, Comcast had reason to challenge the

Board's determination of the proper sales factor for 1999 in its original tax refund claim. Its failure to do so forfeits the issue.

DISPOSITION

The judgment is affirmed. The parties are to bear their own costs on appeal.

PERLUSS, P. J.

We concur:

ZELON, J.

KEENY, J.*

* Judge of the Los Angeles County Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.